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SENSITIVE

STATE FOR EUR/SE, EB/IFD/OMA AND E
TREASURY FOR OASIA - MILLS AND GUNARATNE, AND OFFICE OF TRADE FINANCE
STATE PASS USTR - NOVELLI AND BIRDSEY

E.O. 12958: N/A
TAGS: ECON EFIN PREL TU
SUBJECT: IMF AND TURKISH CENTRAL BANK ON NEXT STEPS FOR THE ECON PROGRAM: FOCUS ON FISCAL TARGETS

Sensitive but Unclassified. Not for internet distribution.

¶1. Summary: While the post-election market rally largely continued on November 8, with T-bill rates dropping a further 2.5 percent, there was by the week's end greater press and market attention to the likely policies of the new GOT. IMF resrep reviewed with us the outstanding structural and fiscal conditions on the Fourth Review; he hopes to have AK agreement to a November visit by IMF's Deppler, followed by a full Mission visit in December. The AK figures have yet to meet with the economic bureaucrats, but Central Bank staff told us they plan to stress to AK leaders: "stick with the 6.5 percent of GNP primary surplus target." End Summary.

¶2. (U) The strong market rallies largely continued on November 8, on the back of local buying (Central Bank sources say they didn't see large foreign inflows this week). Lira-denominated T-bills dropped another 2.5 percentage points to close at 53 percent compounded. The lira appreciated one percent to close at TL 1,619,000. Profit taking in the Istanbul stock exchange led to a 1.8 percent decline, after a record week for trading volume. Volume in the stock market today was $1.55 billion (versus prior daily averages of about $200 million.)

IMF Resrep on Next Steps

¶3. (SBU) IMF resrep Brekk, meeting with visiting EUR/SE director, said he spoke with AK's Ali Babacan today. Brekk believes AK will agree to a courtesy visit by IMF's Europe 1 director Michael Deppler in late November, to be followed by a full fledged IMF Mission visit in December, once the new government is fully in place. Brekk noted that AK leadership had focused first on EU accession, and had been briefed by bureaucrats on EU issues, but had not yet engaged the bureaucracy on the economic reform program issues. When they did meet with Treasury and Central Bank, AK would learn of the outstanding conditions on the Fourth Review.

¶4. (SBU) Among the key outstanding structural reform conditions are:

-- Banking Board's resolution of Yapi Kredi Bank's share ownership (still being negotiated with controlling shareholder Mehmet Karamehmet.)

-- Submission to parliament of the direct tax reform bill. (IMF has not seen a draft law, though there was agreement in principle with MinFin Oral on contents of such a law. Finance Ministry DG told us he will wait to show draft to new AK MinFin before giving to IMF.)

-- Reducing redundant jobs in state companies. (GOT is about 10,000 short of the 31,000 jobs identified as redundant in a GOT study of state companies. This will require lay-offs, which remains sensitive.)

-- Adoption of Tekel privatization plan. (The planned restructuring of state alcohol and tobacco giant TEKEL goes beyond the mandate of the Privatization Administration, since it requires lay-offs and ending tobacco price supports. Thus the plan must be submitted to the new GOT.)

¶5. (SBU) The most important concern under the IMF program remains the primary budget surplus, see septel.

Central Bank Staff Optimistic About 2003,
If AK Government Keeps Budget Tight

¶6. (SBU) Central Bank Markets DG Akil Ozcay told us November 8 that he is optimistic about 2003, provided the new GOT keeps a tight fiscal policy. "We'll tell the new government that the 6.5 percent primary surplus target is not the IMF target, it's the Treasury's and Central Bank's target. It's the anchor of our reform program, th the key to bringing down real interest rates and reducing the government's borrowing costs in 2003."

¶7. (SBU) On inflation trends, Ozcay said the latest expectations survey showed a year-end 2002 expectation of 31 percent CPI growth - well under the year-end 35 percent target. However, the year-end 2003 expectation was currently 24 percent - above the program target of 20 percent. Ozcay is confident that this expectation could be lowered by maintaining tight monetary and fiscal policies. He recalled that no one expected at the beginning of 2002 that the CPI target of 35 percent would be met. Ozcay noted the market pressures for the Central Bank to lower its overnight rates, now that inflation was under program targets. He said the Central Bank was hesitant to join the "exuberance bandwagon" and thus might wait a bit before cutting rates.

¶8. (SBU) Other economic indicators were also good, per Ozcay. On the balance of payments, current account numbers were stronger than projected - the Central Bank now sees a year-end current account deficit of about $500 million (versus the projected $1.5 billion). He attributed this performance both to over-performing export growth, despite the real lira appreciation and to the record year for tourism - expected revenue of just under $10 billion. He expects net capital inflows in 2003, pointing to this week's successful Eurobond offering.

PEARSON